

§ 1773.32 Report on compliance and on internal control over financial reporting.

As required by GAGAS, the CPA must prepare a written report describing the auditors testing of compliance with applicable laws, regulations, contracts, and grants, and on internal control over financial reporting and present the results of those tests. This report must be signed by the CPA and must include, as a minimum:

(a) The scope of the CPA's testing of compliance with laws and regulations and internal control over financial reporting including whether or not the tests performed provided sufficient evidence to support an opinion on compliance or internal control over financial reporting and whether the CPA is providing such opinions;

(b) If conditions believed to be material weaknesses considered to be reportable conditions are disclosed, the report should identify the material weaknesses that have come to the CPA's attention;

(c) If no reportable instances of non-compliance and no reportable conditions were found, the CPA must issue a report as illustrated in RUS Bulletin 1773-1.

(d) If material instances of non-compliance and reportable conditions are identified, the CPA must issue a report as illustrated in RUS Bulletin 1773-1.

(e) Other nonmaterial instances of noncompliance should not be disclosed in the report on compliance and on internal control over financial reporting, but should be reported in a separate communication to the board of directors, preferably in writing. All such communications must be documented in the workpapers and submitted to RUS in compliance with § 1773.21.

(f) If the CPA has issued a separate letter detailing immaterial instances of noncompliance, the report on compliance and on internal control over financial reporting must be modified to include a statement such as:

We noted certain immaterial instances of noncompliance, which we have reported to the management of (borrower's name) in a separate letter dated (month, day, year).

(g) If the CPA has issued a separate letter to management to communicate

other matters involving the design and operation of the internal control over financial reporting, the report on compliance and on internal control over financial reporting must be modified to include a statement such as:

However, we noted other matters involving the internal control over financial reporting that we have reported to the management of (borrower's name) in a separate letter dated (month, day, year).

(h) The report must contain the status of known but uncorrected significant or material findings and recommendations from prior audits that affect the current audit objective.

[63 FR 38723, July 17, 1998, as amended at 66 FR 27836, May 21, 2001]

§ 1773.33 Management letter.

The CPA must prepare a management letter that includes, at a minimum, comments on:

(a) *Audit procedures.* State whether the audit has been performed in accordance with this part;

(b) *Special reports.* State whether any special reports, summaries of recommendations, or similar communications were furnished to the borrower's management during the course of the audit or during interim audit work, and provide a description of the information furnished;

(c) *Accounting and records.* Comment on the adequacy and effectiveness of the borrower's accounting procedures, discuss the general condition of the records, and outline any recommendations for improvement. Comment on the adequacy and fairness of the methods used in accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts, and where appropriate, include:

(1) Whether continuing property records (CPRs) have been established, are updated on a current basis, at least annually, and are reconciled with the controlling general ledger plant accounts;

(2) Whether construction clearing accounts are cleared promptly of costs of completed construction to the proper classified plant accounts and whether

depreciation was accrued on such completed construction from the date the plant was placed in service;

(3) Whether retirements of plant are currently and systematically recorded and properly priced;

(4) Whether all costs associated with retirements of plant are properly accounted for in the accumulated provision for depreciation accounts and comment on any unusual charges or credits to such accounts; and

(5) Whether RUS approval was obtained for the sale, lease or transfer of capital assets secured under the mortgage when approval is required, and whether proceeds from the sale or lease of plant, material or scrap were handled in conformance with RUS requirements.

(d) *Materials control.* Comment on the adequacy of the control over materials and supplies.

(e) *Compliance with RUS loan and security instrument provisions.* State whether the following provisions of RUS' loan and security instruments have been complied with:

(1) For electric borrowers, provisions related to:

(i) The requirements for a borrower to obtain written approval of mortgagees to enter into any contract for the management, operation, or maintenance of the borrower's system if the contract covers all or substantially all (90 percent) of the electric system. For purposes of this part, the following contracts shall be deemed as requiring RUS approval:

(A) Management contracts in which the borrower has contracted to have another borrower or other entity manage its affairs;

(B) Management contracts in which the borrower has contracted to manage another borrower or other utility system;

(C) Operations and maintenance contracts in which the borrower has contracted to have another borrower or other entity operate and/or maintain all or substantially all (90 percent) of the physical plant facilities of the borrower.

(D) Operations and maintenance contracts in which the borrower has contracted to operate and maintain the

physical plant facilities of another borrower or other utility system; and

(ii) The requirement for a borrower to prepare and furnish mortgagees annual financial and statistical reports on the borrower's financial condition and operations. For borrowers with a December 31 year end, the CPA must state whether the information represented by the borrower as having been submitted to RUS in its most recent December 31 RUS Form 7 or Form 12 is in agreement with the borrower's audited records. For borrowers with a year end other than December 31, the CPA must state whether the information appears reasonable based upon the audit procedures performed. If the borrower represents that an amended report has been filed as of December 31, the comments must relate to the amended report.

(2) For telecommunications borrowers, provisions relating to the requirement for a borrower to obtain written approval of the mortgagees to enter into:

(i) Any contract, agreement or lease between the borrower and an affiliate other than as allowed under 7 CFR part 1744, subpart E;

(ii) The requirement for a borrower to prepare and furnish mortgagees annual financial and statistical reports on the borrower's financial condition and operations. For borrowers with a December 31 year end, the CPA must state whether the information represented by the borrower as having been submitted to RUS in its most recent December 31 RUS Form 479 is in agreement with the borrower's audited records. For borrowers with a year end other than December 31, the CPA must state whether the information appears reasonable based upon the audit procedures performed. If the borrower represents that an amended report has been filed as of December 31, the comments must relate to the amended report.

(f) *Related party transactions.* State whether all material related party transactions have been disclosed in the notes to the financial statements in accordance with SFAS No. 57, entitled "Related Party Disclosures". If the audit did not disclose any related party transactions considered to be material,

either individually or in the aggregate, so state;

(g) *Depreciation rates.* For electric borrowers, comment when the depreciation rates used in computing monthly accruals are not in compliance with RUS requirements (See RUS Bulletin 183-1, Depreciation Rates and Procedures), which require the use of depreciation rates that are within the ranges established by RUS for each primary plant account, or with the requirements of the State regulatory body having jurisdiction over the borrower's depreciation rates; and

(h) *Deferred debits and deferred credits.* For electric borrowers, provide a detailed analysis of the totals reported as deferred debits and deferred credits, including, but not limited to, margin stabilization plans, revenue deferral plans, and expense deferrals. The CPA must state whether RUS has approved, in writing, each regulatory asset and liability.

(i) *Investments.* For electric and telecommunications borrowers, provide a detailed schedule of all investments in subsidiary and affiliated companies accounted for on either the cost or equity basis. This requirement includes investments in corporations, limited liability corporations and partnerships, joint ventures, etc. For all investments list the name of the entity, ownership percentage, and the principal business in which the entity is engaged. For investments recorded on the cost basis include the original investment, advances, dividends declared or paid in the current and prior years and the net investment. For investments recorded on the equity basis include the ownership percentage, original investment, advances, and current and prior years' earnings and losses, including accumulated losses in excess of the original investment.

[56 FR 63360, Dec. 3, 1991, as amended at 59 FR 659, Jan. 6, 1994; 61 FR 108, Jan. 3, 1996. Redesignated and amended at 63 FR 38723, July 17, 1998; 63 FR 40169, July 28, 1998; 66 FR 27830, May 21, 2001]

§§ 1773.34–1773.37 [Reserved]

Subpart E—RUS Required Audit Procedures and Documentation

§ 1773.38 Scope of engagement.

(a) RUS requires that the audit procedures set forth in §§ 1773.39 through 1773.45 be performed annually by the CPA during the audit of the RUS borrowers' financial statements, which audit procedures may be in addition to the conduct of a GAGAS audit.

(b) The CPA must exercise professional judgment in determining whether any auditing procedures in addition to those mandated by GAGAS or this part should be performed in order to afford a reasonable basis for rendering the auditor's report, report on compliance and on internal control over financial reporting, and management letter.

[56 FR 63360, Dec. 3, 1991, as amended at 66 FR 27835, May 21, 2001]

§ 1773.39 Utility plant and accumulated depreciation.

(a) *General.* The audit of these accounts must include tests of additions, replacements, retirements, and changes. Based upon the CPA's determination of materiality, an appropriate sample of transactions must be selected for testing. The CPA's workpapers must document that he/she:

(1) Examined direct labor and material transactions to determine whether the borrower's accounting records reflect a complete accumulation of costs;

(2) Examined indirect costs and overhead charges to determine if they conform to the Uniform System of Accounts;

(3) Reviewed the costs of completed construction and retirement projects to determine if they were cleared promptly from the work in progress accounts to the classified plant in service accounts and the related depreciation reserves;

(4) Examined direct purchases of special equipment and general plant;